RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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April 3, 1985 LETTER 910

March 22 DJIA 1267.45; PTI 1682; A-D Ratio -17.13
March 29 DJIA 1266.78; PTI 1700; A-D Ratio -16.67

THE MARKETS: As I've written many times before, the hardest thing to do in this business is to stay humble. When you spend most of your waking hours studying the markets, business and the economy, you're bound to develop some opinions, some concepts and some scenarios. And that's all well and good. And it's often fascinating. But if you want to survive either as an investor or as a market analyst, you better not let your preconceived notions dictate to your vision. In other words, think all you want, but WATCH those markets.

I guess I read about 25 investment letters each week, and obviously, a good many of these advisors are smart, bright, even brilliant. So it's impossible to simply dismiss what they say -- even if it clashes with what I see or what I think.

I'll give you an example. Both Julian Snyder and Joe Granville see the current situation as highly dangerous with the downward segment of the great Kondratieff cycle now exerting increasing force on the markets. Julian sees oil heading for a great fall, and he sees acute danger in the banking system. In fact, a crash of world markets would not surprise Snyder at all. Much the same view is held by Joe Granville. Joe sees financial immorality, fraud, scandals, money laundering, bank failures, all as background for a massive top that he believes is now forming in the markets. And from what Joe tells me, he is preparing a book which compares hundreds of similarities between today's market and that of 1929.

Now, let's mull over some fundamentals. I just received the "Industry Forecast" letter put out by the Levys of Chappaqua, NY. I've been following their forecasts for years, and let me tell you their record has been superb. To be blunt, the Levys believe that the economy is moving into recession -- and not just a mild recession. Here is their latest conclusion: "These are perilous times. The dollar is too high, and the federal deficits will increase. Unneeded buildings are still rising. Problems with domestic and foreign loans will again become acute. The developing recession will be severe."

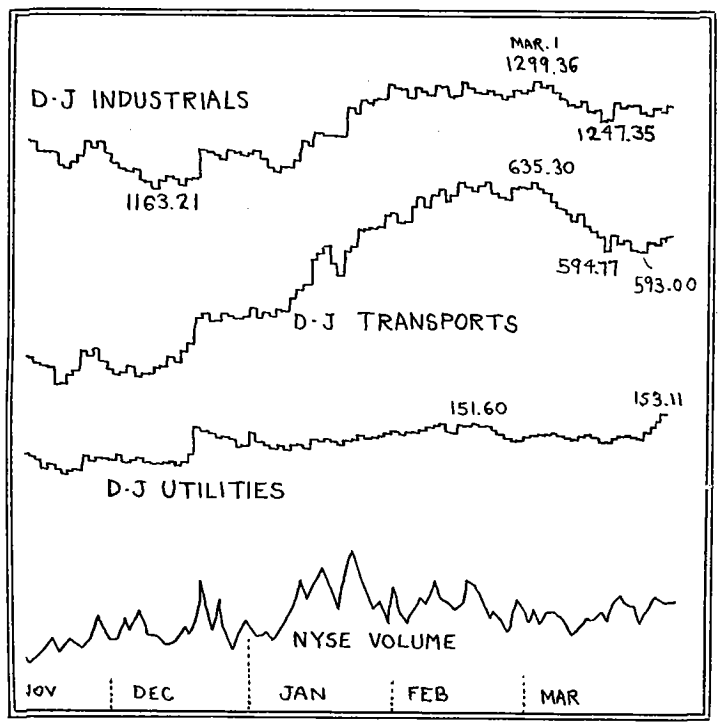
And I sit on my back patio and look over the wide, blue Pacific (I live about 100 yards from the ocean) and I ask myself, "Could Snyder be right? Could Granville be right? Are the Levys right? Is the great post-World War II joy-ride about to end?" And I wipe the sweat off my brow and continue, "And if there is a recession and corporate profits cave in, what will the 1986 federal deficit look like -- $250 billion, $300 billion, more?"

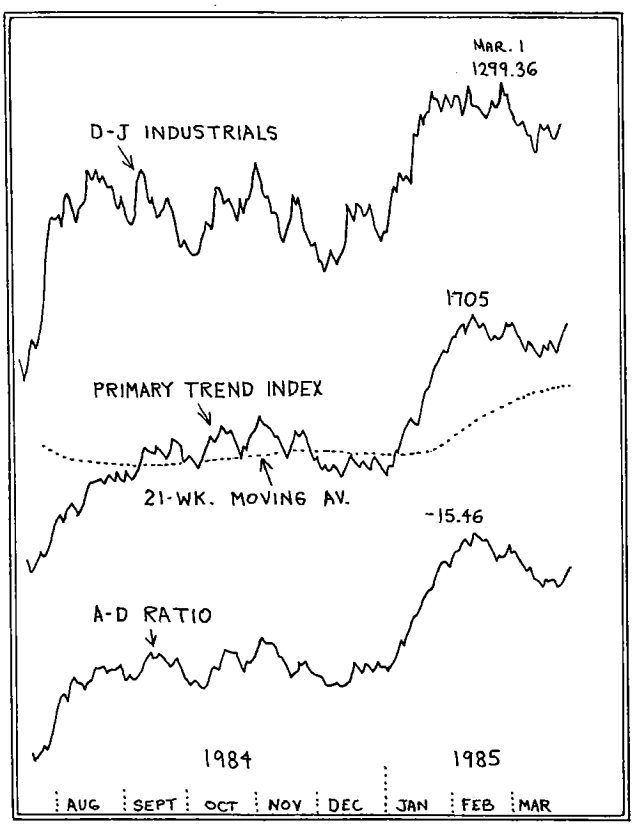
I'll tell you the truth. Nobody has the answer to what's coming up! If they did, I'd be sitting at their feet. But sadly, there's no such person and no such group. So I use the best forecaster, the best barometer that I know of. And I'm talking about the stock market, and more specifically the NYSE.

There are a couple of points I should make. First, the odds are always against a catastrophe. Catastrophes do occur, but they are extremely rare. Now obviously, one day somewhere ahead, the market is going to hit its ultimate post-World War II peak. After that, the market is going to turn down in what could be the worst bear market since 1929-32. And I guess some brilliant (or lucky) advisor will call the top -- right on the button.

Now let's consider this. The majority of the major stock averages hit their all-time highs during mid-February or early March 1985. Those new highs constituted a reconfirmation of the primary bull trend of the market. There's no sense fighting that fact -- it happened and it was important.

It's also true that in the course of a major bull market (such as this one) we will see many record highs in the averages. Again and again the averages will better preceding peaks and reconfirm the primary bull trend. But eventually, there will be a bull signal (i.e., a bull reconfirmation) that will be the final one -- the one that will appear just prior to the next bear market. And obviously, that is the one that we have to watch out for.





But I do like to keep it simple. The fact is that the D-J Industrial and Transportation Averages struck record highs on March 1, Industrials at 1299.36, Transports at 635.30. I haven't seen anything since then to cause me to believe that "it's all over". I haven't seen evidence yet to make me think that the bull market has breathed its last. True, we've had some sloppy days. True the electronic shares have been hit hard. And those two bellwethers, IBM and GM are well off their highs. And the foreign currencies and precious metals (heaven help us) have built bases and are now pushing up out of those bases.

It isn't always the case, but the price action in the D-J Averages is very helpful now. Study the page 1 chart. Note that the D-J Industrial Average recorded a March 15 low of 1247.35. A day later the Transportation Average recorded a low of 594.77. A little rally ensued, followed by a new decline. On the second decline, the Transports broke to a March 26 low of 593.00. Industrials refused to confirm the lower low of the Transports. In the face of this clear downside non-confirmation, the market rallied.

The boundaries for the Averages could not be clearer. On the upside we have the highs of 1299.36 (Industrials) and 635.30 (Transports). A JOINT bettering of these highs will once again sound the "all clear" for the market. Conversely, if the Averages turn down and break the lows of 1247.35 and 593.00, we will have a bearish signal. In my opinion, such a bearish signal (if it occurs) should be taken very seriously and would be cause enough to lighten up on all equities.

A definite plus for the market occurred on March 28 when the D-J Utility Average rose to a closing high of 152.85. This is the highest level for the Utility Average since 1966. In the past the Utility Average has tended to be a bellwether, and we can only hope that it proves to be a bellwether now.

Another plus is the new bull market high in the cumulative most-active stock index recorded on March 28. This index (which is an A-D line of the most-active pluralities on the NYSE) has been consistently the most bullish item in my entire technical spectrum. So far, it's been very correct.

The PTI action is particularly interesting now. Note that the PTI has been acting stronger than either the Dow or the A-D ratio. I've seen this kind of action before, and I've been fooled by it before. When the PTI pushes up and the market refuses to follow, it is a case of the technicals "burning out" on the upside without doing any real good for the market. In other words, the technicals become exhausted on the upside, but they don't succeed in lifting the market. That could be what is happening now.

So while it's true that the PTI is holding well above its moving average it is also true that the market (and the averages) have been reluctant to follow. In fact, the broad Value Line Composite made a new low last week. So I want to repeat--IF Industrials turn down and break 1247.35 confirmed with a Transport breaking of 593.00, take that as a real danger signal. Keep those two points fixed firmly in your mind, please!

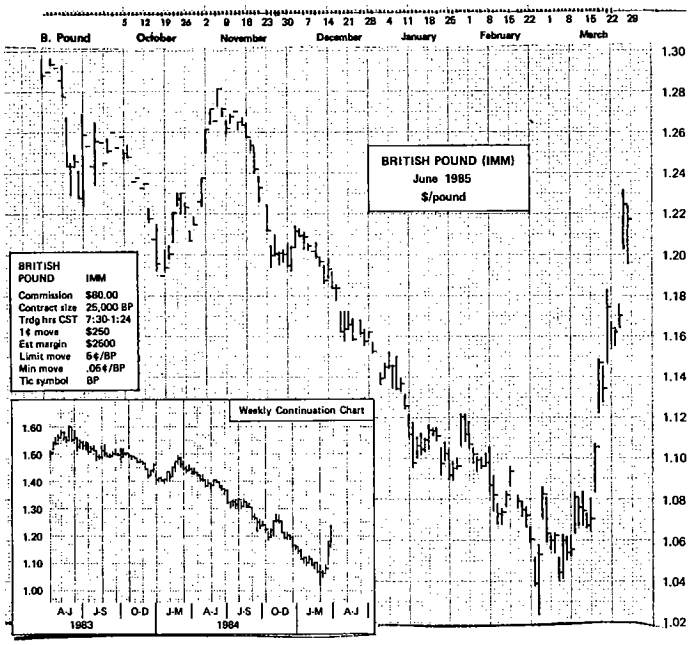
INVESTMENT POSITION: The bull remains in the box. But it's a nervous bull. The PTI is still well above its moving average, the D-J Industrial and Transport Averages hold above their 1247.35 and 593.00 lows and the D-J Utilities have just set a 19 year high. On the other hand, two of the big bellwethers, IBM and GM are questionable, and the adverse balance-of-trade figures are now exploding.

We sit with our stocks and funds as long as the PTI and the Averages behave. General Foods, American Home Products, American Brands, all act superbly well as do Nabisco and Kellogg (all previously recommended). The brightest light in the current picture is the utilities. Good yielders in the group are Empire District Electric, Interstate Power, Utah Power, Idaho Power. San Diego G & E (with about the highest rates in the nation) is good for shareholders, rotten for those of us who pay the electric bills (although I've gone through this San Diego winter without using any heat at all).

DOLLARS AND FLIGHT: I started saying it back in Letter 908. I believe the dollar has topped out. I've been a little more certain that we've seen the best for the dollar with each successive Letter since 908. The evidence just keeps getting stronger.

Study this chart (chart courtesy Dunn & Hargitt) of the British pound in terms of dollars. This is a move that I must say I called right on the bottom. The force of the pound rise has been extraordinary. In the space of a few weeks the pound has appreciated almost 20% against the dollar! What we see here is an island reversal at the bottom--and then two explosive upside breakaway gaps. In my opinion. we've seen the low for the pound and the peak for the dollar. I'm 95% convinced.

In all the foreign currencies the story is the same--good bases and big climbs against the dollar.



Confirming the new strength in foreign currencies are the rallies in the precious metals. For the first time in a long time one can make a case for the metals having seen their lows (see gold section, page 6).

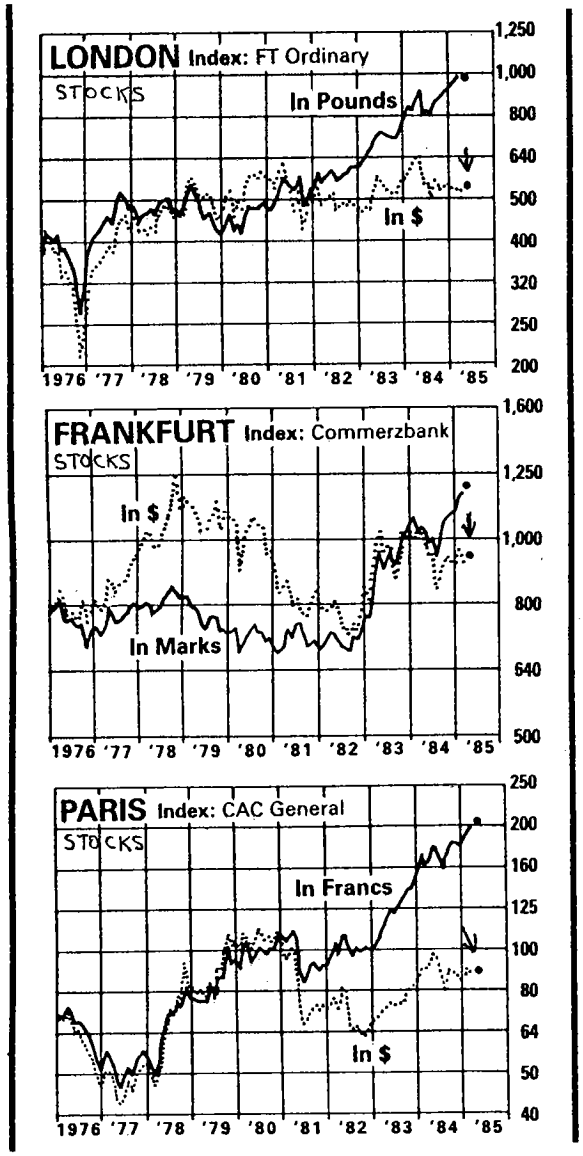
Everybody in the US has been waiting, hoping, praying for dollar weakness. Now we have it. What will this mean? For one thing, it will be a plus for US exporters. A sliding dollar means that US exports will be cheaper for foreigners to buy. A sliding dollar will hurt US tourists, since a lower dollar means foreign goodies become more expensive.

But a declining dollar will also present problems, and in my opinion the biggest problem will be an exit of foreign capital from US markets. When you realize that foreigners have been big buyers of the US government's debt, a complete reversal (with foreigners selling US debt) would present MAJOR problems. If that happened, interest rates might go through the roof as our Treasury pays whatever it has to--to keep money here and to sell new Treasury debt.

At this point, all the "experts" seem to think that the dollar decline will be a mild and orderly affair. It wasn't mild and orderly on the upside, and it may well be that the dollar decline will be rough and relentless on the downside. At any rate, I want to illustrate what could occur if the dollar starts down in earnest.

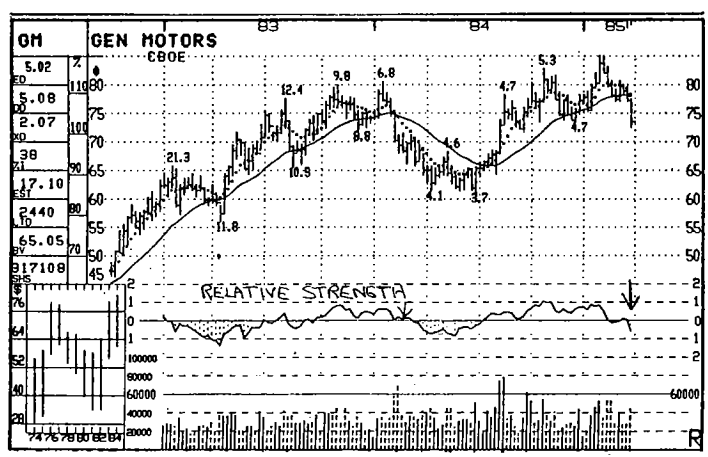
Here are a few charts (courtesy of Value Line) that show some major foreign stock indices in terms of their own currencies and in terms of dollars. Note that the British, German and French stock indices have boomed in their own currencies. But in dollars (dotted lines) London is below its 1981 peak, Frankfurt is far below its 1978 peak and Paris is well below its 1980 peak. Fantastic! It's something very few people are aware of.

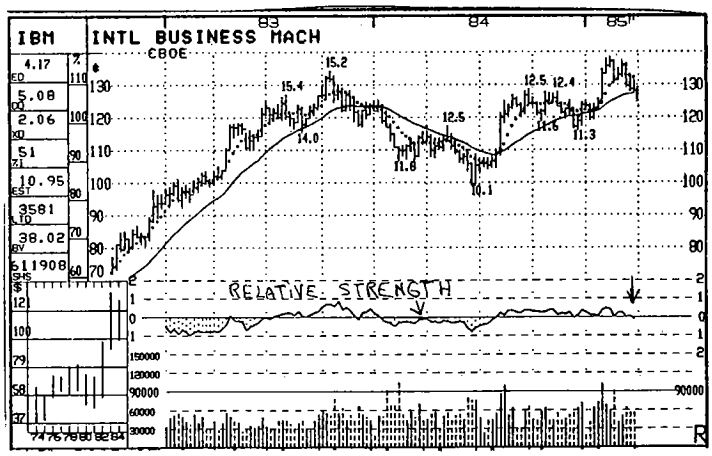
Now reverse the situation. Say the dollar has topped out. In terms of foreign currencies the US stock and bond markets have to be a sale. Thus, a dollar top-out could set off major selling on the part of the foreigners. If they don't sell, they stand a good chance of losing their shirts, just as American buyers have lost their shirts in the German, French and British markets over the last four or five years (even though the trend of those markets in foreign currencies has been bullish).



LEADERSHIP? Call me a worrywart. But I do note that two of the big market leaders, bellwether IBM and GM are not looking good. These two Mansfield charts tell the story. GM has now broken below its moving average and below its December low. At the same time, its relative strength line has turned down. That bothers me.

IBM has dipped just below its moving average and its relative strength line could be in the process of turning down. Neither of these stocks are THE



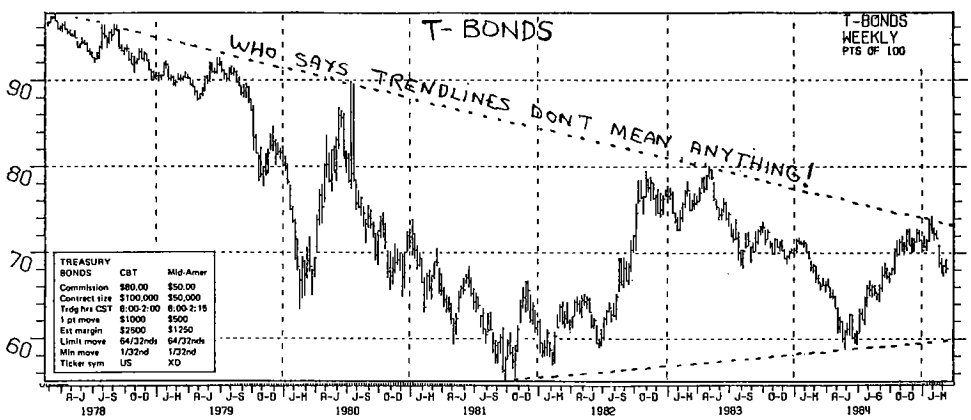


market, but they are both bellwether leaders. Their weakness has me a bit on edge, and I wanted to bring this to the attention of subscribers. The picture, in other words, is not all wine and roses.

BONDS, RATES: The bonds formed what appeared to be a big top. But they have been rallying (correcting) since mid-March. One thing is for certain--bonds and the precious metals will not rise together for long. One or the other is going to turn around, and my guess is that it will be bonds.

I want to show a much larger perspective on the bonds. This is Dunn & Hargitt's eight year weekly chart of the bonds. Note that the T-bonds have now formed a massive five-reversal point triangle. Point 5 was the January-February 1985 top. The picture from here will be highly significant. A breakout above the upper triangle limits (above 74 on the June T-bond contract would be highly bullish for bonds.

But-a failure here could send the bonds down towards the lower trendline in the 60 area. If that happens--well, let's discuss it if or when it occurs.



UNUSUAL STOCKS: This is the third "unusual stock" that I am presenting. It is a sister to Tri-Continental preferred. This stock is the cumulative preferred issue of Source Capital, Inc. (NYSE). SOR is a closed-end fund holding assets of about $250 million. The assets are invested in a high-quality portfolio of common stocks (79%) and the rest in bond and assorted foreign shares. Ahead of all this is an issue of two million shares of cumulative preferred shares each with a dividend of $2.40.

Income for the entire fund runs about $18 million. But before anything is paid to the common stock, the preferred gets a total of $4.8 million. There are no bonds. Thus SOR preferred pays a VERY safe dividend, the preferred is cumulative, and this means that if for some catastrophic reason the preferred skips a dividend, that dividend will be made up when times are good again.

The stock is excellent for corporations that need a super-safe good yielding issue which is 85% free of federal taxes. As you may know, all stock dividends to corporations are 85% free of federal taxes, unlike bonds. This issue and the Tri-Continental preferred are both unique stocks.

MORE TRUTH: The piece I wrote in Letter 903 on truth seems to have set off a storm of letters. Obviously, a lot of my subscribers are interested in the truth and the reason for telling (or avoiding) the truth. So I want to write a bit more on truth (which happens to be one of my favorite subjects).

I think it's not only morally right to stick with the truth, I believe it's necessary for your health to stay with the truth. I wrote in Letter 903 that there is a close relationship between untruth (lies) and insanity. For just as a lie is a distortion of reality, a disease is a distortion of the physical.

Scientists and medical people are finding that the immunity system is one of the keys to sickness or health. Furthermore, they find that the unconscious mind has a strong influence on the immunity system. In other words, if a person feels guilty or stressed, he may (unconsciously) allow his immunity system to let down. This action may trigger a disease.

The person who tells a lie usually knows that he is lying. That action always sets off stress or guilt (except in the case of the sociopath who, by definition, has no conscience). The stress or guilt. that is set off by the liar is going to work against the physical or mental system of the culprit. The worse the lie, the greater the stress and guilt and the unhealthier the person.

Beyond all this, I have a theory which I call the theory of "psychic strength." I think that each time you are in a difficult situation and you choose the path of truth in that situation, you build up your psychic strength. And as your psychic strength gets stronger, your whole mental and physical being becomes stronger. Conversely, each time you get into a difficult situation and you avoid, lie, omit, distort, your psychic strength deteriorates. And as your psychic strength gets weaker, the whole organism becomes weaker.

Most people absolutely do not comprehend the mechanism of the lie. But here is a vital point. The liar gives away his power. Example: a husband stops at a restaurant on the way home and has a cup of coffee at the counter. A pretty girl is sitting next to him. He starts a conversation, flirts, has fantasies of a sub-rosa romance, but finally decides that faithfulness is best and he heads home.

The husband arrives home, kisses his wife. She asks, "It's 6PM. Where have you been?" He answers, "Oh, I stopped for a cup of coffee and got in a conversation with an old college friend." The half truth has been told, but he lied as well. He did have coffee but the "old college friend" was a pretty girl.

What has the husband done? He has given his wife POWER OVER HIM. By lying to her, he has indicated that he is afraid of her possible reaction. He has therefore (through his lying) turned his wife into the female ogre, the all-powerful bad mother, the woman who has so much power over him that he cannot muster the strength to tell her the truth.

What would a strong man do under the same circumstances? He would come home and say "I'm late. I dropped into a cafe to have a cup of coffee and I flirted with a pretty girl sitting next to me. But don't worry, I'm here, and that's where I want to be."

Thus, in the second instance the husband has revealed all, kept his power, treated his wife as a true equal, and stood up for his actions (right or wrong, they were HIS actions, and his wife undoubtedly knows that he is a harmless flirt anyway). In standing up for his actions, in possessing the courage to tell the truth, this man is stronger. As to his flirting, he will have to decide whether he wants to continue as a flirt or not. But at worst, he is an honest flirt, an out-in-the-open flirt.

A final comment (I could write about this for a month). In telling his wife where he is and what he is doing, this man is keeping his life TOGETHER. In other words, he isn't psychically split. His left hand knows what his right hand is doing. Remember the following and it will answer a great many questions: "Insanity is that part of you that you keep secret. What you won't reveal is your personal insanity."

I've had experience personally with a lot of insanity. I have a daughter who is autistic (infantile schizophrenia). The essence of insanity is that which goes on in the insane's mind that is NOT REVEALED. And that is very close to the action or deception) of the liar.

NOTES & QUOTES: I don't know what it is. I don't know if some of the things I write set people off, or whether readers have an urge simply to communicate with me. And I love it. Readers also bring all sorts of information to my attention. But, and here's the point. I simply can't answer all the letters that come in. I don't have writing assistants here. I don't have a board. I do all the writing myself, and if I have to answer five or ten letters a day I can't do anything on my own report. I haven't got the energy.

All this bothers me, because I think I am conscientious, and I want to do right by my subscribers. But I can't provide answers to all these letters coming in daily. I read each letter carefully, I appreciate each letter (some are complimentary, some are critical, some point out errors). Anyway, thanks for the letters but "gimme a break." Keep 'em coming but don't demand answers. There's just one jerk here writing this thing.

Wait, there's more. I get many letters from people who frankly admit that they read these reports at their broker's office or at their neighbor's house. I walked into an E.F. Hutton office the other day, and darned if they weren't running off around 50 copies of my Letter. I don't want to sue Hutton. they're good folks even if they are committing an illegal act. I figure this way: a lot of people write in and they're honest enough to say that they used to read the Letter at Merrill or Hutton or the Miami public library and now they've moved to Albany or Abilene and they miss the Letter so here's a check for a subscription. So it all evens out, and I never call a lawyer. I figure that people have to live with their own good or bad karma. And so much for this section; I've got it all off my chest.

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Michael Evans, a top economist, writes, "And now for the bad news. Suppose we do get the modified freeze--Social Security, Medicare, government employee raises and retirement benefits--and Congress does shake $12 billion off the defense budget. Total non-defense outlays for THIS year have crept up so much when no one was looking--$43 billion, to be exact--that the deficit for 1986 will still be more than $200 billion." That, states Evans, means tax INCREASES, probably for corporations--of about $25 billion.

Remember when I wrote that the career Congressmen and Senators are something that the Founding Fathers never planned on. They are people who should be thrown out of office. It is this emphasis on getting elected again and again that has fouled up our system. A man who puts getting elected first, puts personal power above his country, and that is why we cannot get our boys in Washington to act reasonably. This is the opening of a February 19 article from the New York Times.

Special to The New York Times

WASHINGTON, Feb. 18 — In the dense cloud of mind-boggling billion-dollar statistics swirling around the Federal budget debate, one simple number stands out. It is 22, the number of Senate seats held by Republicans that will be up for re-election next year.

In the early weeks of the new Congress, it is already clear that the Republicans' determination to protect those seats is driving many of their basic decisions about the budget. But the best political course for the Republicans is still far from obvious, and the whole subject has many of them quivering with anxiety.

Senator John Heinz of Pennsylvania, chairman of the National Republican Senatorial Committee, said recently that President Reagan's budget, with its proposals for increased Pentagon spending and deep cuts in domestic programs, had put many Republican senators "between a rock and a hard place." One of the 22 who feels particularly wedged in is Mr. Heinz's fellow Pennsylvanian, Arlen Specter.

"Every vote that comes up in the budget," Mr. Specter said, "is a potential vote loser for me in November of 1986."

* *

Quote of the Week: From an interview with Stephen Bryan, deputy assistant secretary of defense, discussing a major study of transferring technology to Russia (from USA Today); Question: How much of the Soviets' military system is based on Western technology? Answer: "I'm tending to think about half. Some of it is very direct and some of it is very indirect. Certainly in the electronics area it's overwhelming."

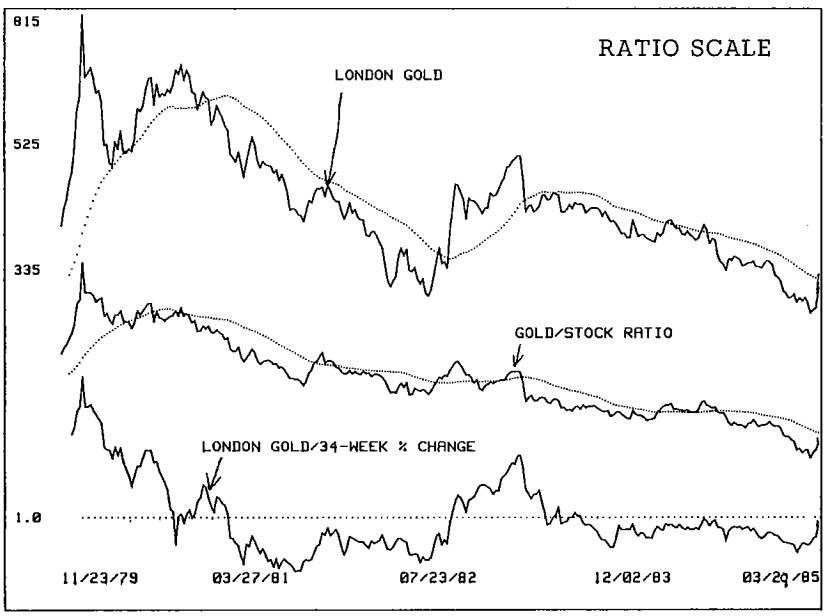
* *

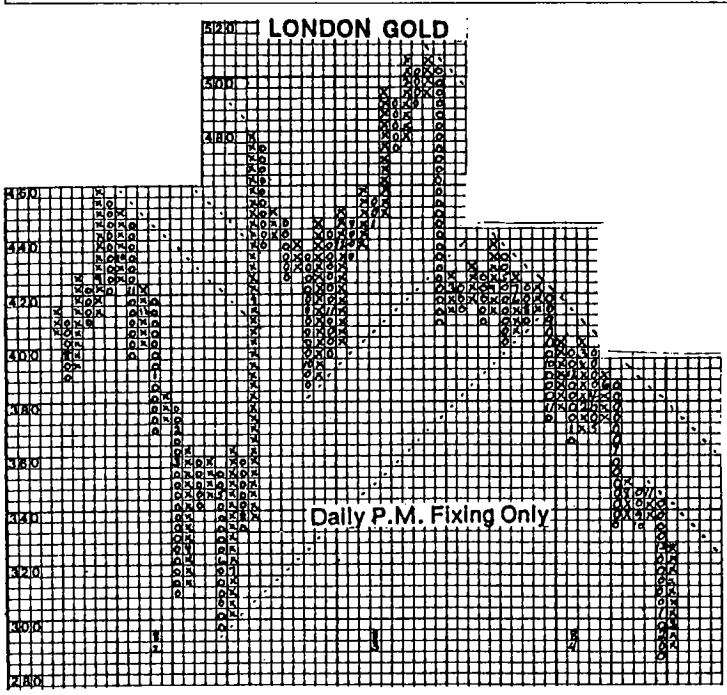
Dept. of Interesting Statistics: The Japanese save an average of 20% of their wages. The Japanese have bought and are buying huge amounts of US debt (via T-bonds and notes). Question, if and when recession hits the US and the dollar tops out, how high do US interest rates have to go to hold foreign money here? Answer: Very high, I'm afraid.

* *

The US international trade position is growing increasingly tenuous. The net US international position has collapsed from a peak of plus $169 billion in 1982 to a minus $30 to $70 billion this year. The way it's going, by 1989 the US external debt could reach $1 trillion, thereby passing the external debt ($810 billion) of all the developing nations in 1984. This could be a main reason why the dollar is turning weak.

There is almost a conspiracy of silence about the danger in the US trade position. The fact is that political and economic strength go hand in hand with a nation's trade position. The trade position is a barometer of a nation's clout. Look at tiny Japan, a nation that would be nothing without its ability to produce and export. Then look at mighty America and its collapsing trade position. We're told that we've become a "communications nation" rather than a manufacturing nation. All I can say is that if that's the case we better learn how to export talk and computer print-outs.





GOLD: Two weeks ago gold enjoyed its biggest one-day rise in history (up almost 10%). Is gold rising as it discounts forthcoming inflation, or is gold simply reflecting the falling value of the dollar? Time will tell.

I follow three basic technical studies for gold, and I asked my friend Bob Powers of Cycledata of San Diego to get on his Hewlett Packard computer and run off this chart for me.

The chart (weekly) provides an excellent technical rundown of the metal.

The top line shows the gold price, and here we see that gold has pushed just above its 34-week moving average. Bullish. The middle line shows the ratio of gold to the S&P 500 stock index, and we note that the ratio has halted just short of its 34-week moving average. Inconclusive. The bottom line shows gold momentum or the 34-week rate-of-change for gold. The momentum has not quite advanced above 1.0, which means that gold is still below its price of 34 weeks ago. Trend is hopeful, but so far still inconclusive.

The point & figure chart (courtesy of Chartcraft, Larchmont, NY) shows the most recent long decline in gold to the 280 box, then the rally to 328. This kind of action is often the prelude to a bottom. More specifically, a potential head-and-shoulders bottom exists, but this will require a spot gold rise to the 348 level, a pullback, and then a rise into the 350s. Note that the lower declining trendline on this chart would be reversed on a gold rise to 348. The more important (higher) declining trendline would be reversed on a gold rise above 380. I do think that it is important for gold to get above 348. Failing this, I believe there will be disappointment in the precious metals. Gold must get above 348!

LATE NOTES: As I suspected would happen, the dollar's decline is relentless. So far the market likes it. The market closed the week ending March 29 looking good -- new bull market highs for the D-J Utility Average, new high for the cumulative most-active stock index, new highs for on-balance volume on the NYSE and positive volume index on the NYSE. The PTI is within a few points of its 1705 high recorded February 13.

Gold and bonds continue to rise in unison. But a gold rise discounts inflation; bonds rise to discount inflation. Somewhere ahead there's going to be a parting of ways.

ANNOUNCEMENT: For serious stock market students and practitioners, I offer the 1984 sheets of the D-J Averages (daily), containing the D-J Industrials, Transports, Utilities, 20-Bonds and volume -- $2 per sheet. I also have the daily D-J Industrials with the advance-decline ratio for the year 1984 -- $2 per sheet. These go with the historical albums (price for albums on request). These daily studies are invaluable for those who want to learn how to draw intelligent inferences from the price action.

NEXT MAILING: APRIL 17